



[6710-01-P]

FARM CREDIT SYSTEM INSURANCE CORPORATION

Policy Statement Concerning Adjustments to the Insurance Premiums and Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts

AGENCY: Farm Credit System Insurance Corporation.

ACTION: Policy statements; final approval.

SUMMARY: The Farm Credit System Insurance Corporation (Corporation or FCSIC) announces that it has given final approval to a new Policy Statement Concerning Adjustments to the Insurance Premiums and a new Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts (AIRAs). These two policy statements, which were earlier published with a request for comments, reflect amendments to the Farm Credit Act of 1971 made by the Food, Conservation, and Energy Act of 2008, and other changed conditions. The policy statement concerning premiums maintains the Corporation's semiannual review process as a basis for the Corporation's exercise of its discretion to adjust premiums in response to changing conditions. The policy statement concerning the secure base amount and AIRAs maintains the Corporation's general approach to questions concerning the computation of the secure base

amount and allocation and payment of Allocated Insurance Reserves Accounts, with modifications to reflect the legislation and the Corporation's recent AIRAs payments.

DATES: The Policy Statements are effective on December 8, 2011.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

The Farm Credit System Insurance Corporation (FCSIC or Corporation) insures the timely payment of principal and interest on insured debt obligations issued by Farm Credit System banks under the Farm Credit Act of 1971, as amended (Act). The Corporation collects premiums from Farm Credit System (FCS) institutions to fund the Farm Credit Insurance Fund (Fund).

On March 23, 2007, the Corporation's Board of Directors (Board) adopted a legislative proposal requesting that the Congress amend the Act to, inter alia, base premiums on the outstanding insured debt obligations instead of loans, and permit the Corporation to collect a broader range of premiums on insured debt. The legislative proposal reflected the Corporation's concern that, despite generally collecting premiums at the maximum statutory

rates, the Fund was trending away from the "secure base amount," the Corporation's target for the Fund. Provisions incorporating the Corporation's legislative proposal became a part of versions of proposed Farm Bills in the House and Senate. Ultimately, enactment of the Food, Conservation, and Energy Act of 2008 (FCE Act) in 2008 amended the provisions of the Farm Credit Act of 1971 that govern FCSIC premiums to include the Corporation's proposed changes.

The Corporation took action to ensure that the amended provisions of the Act were implemented promptly and that there was a measured and structured transition to the new premium structure. In June 2008, the Corporation's Board of Directors took action to implement the amendments of the Act's premium provisions. The Board implemented (effective on July 1, 2008) the new premium rates and calculation method and adjusted the premiums pursuant to the Corporation's authority under section 5.55 of the Act, as amended by the FCE Act. The Corporation also took action to amend its long-standing regulations concerning premiums. See 12 CFR Part 1410. The Corporation amended its regulations, effective June 9, 2009, to withdraw regulations that were inconsistent with the FCE Act and clarify the effect of the premium provisions of the Act as

amended by the FCE Act. See 74 FR 28156 (June 15, 2009); 74 FR 17371 (April 15, 2009).¹

On June 10, 2011, the Corporation's Board of Directors approved the publication of a revised draft Policy Statement Concerning Adjustments to the Insurance Premiums and a revised draft Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts (AIRAs) with a request for comments. The draft policy statements were published in the Federal Register on June 30, 2011. See 76 FR 38389 (June 30, 2011). The comment period ended on August 1, 2011. No comments were received.

The Corporation has now given final approval to the two policy statements without substantive changes. As revised, the Policy Statement Concerning Adjustments to the Insurance Premiums reflects the FCE Act amendments of the Farm Credit Act. However, the policy statement maintains the existing semiannual consideration of premium rates and the five policy factors that are contained in the present policy. In addition, the Corporation has now given final

¹ In 2009, the Corporation generally limited its amendments of its premium regulations to changes that were necessary in order to eliminate provisions that were obsolete or inconsistent with the FCE Act, and did not add new regulatory definitions. While two new terms, "investment" and "other than temporarily impaired," were added by the FCE Act, the Corporation continues to believe that those terms can be interpreted as accounting terms. Definitions will be added if experience under the new statutory provisions and the regulations leads the Corporation to believe that those two terms, or other terms, should be defined.

approval to the revised Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts. As revised, this policy statement reflects the FCE Act amendments of the Farm Credit Act that affect the secure base amount and Allocated Insurance Reserves Accounts and clarifies how the policy will apply under the new statutory provisions.

As amended, the Act's provisions assess premiums that are generally based on each bank's pro rata share of outstanding insured debt obligations (rather than on loans), aligning premiums with the obligations that FCSIC insures. The amendments reduce the total insured debt obligations on which premiums are assessed by 90 percent of Federal government-guaranteed loans and investments and 80 percent of State government-guaranteed loans and investments, and deduct similar percentages of such guaranteed loans and investments when calculating the "secure base amount." If the Farm Credit Insurance Fund is below the secure base amount (SBA), the amended Act requires that each insured Farm Credit System bank pay FCSIC the premium due from the bank, which shall be equal to (a) the adjusted average outstanding insured obligations multiplied by 0.0020; and (b) the average principal outstanding on loans in nonaccrual status and average

amount outstanding of other than temporarily impaired investments multiplied by 0.0010; subject to FCSIC's power to reduce the premium in its sole discretion.

In addition to changes concerning premiums and the secure base amount, the FCE Act amended the Act to simplify provisions concerning allocation of amounts to AIRAs, and payment of amounts from AIRAs to accountholders. At year-end 2009, the Insurance Fund was \$165.4 million above the SBA. This amount was allocated to the six Allocated Insurance Reserves Accounts. In January 2010, the Board of Directors authorized payment of \$39.9 million from the AIRAs to the accountholders. This amount had been transferred into the AIRAs at year-end 2003. In March, the Board authorized the payment of the \$165.4 million transferred into the AIRAs at year-end 2009 to the accountholders. During 2010, a total of \$20.5 million was paid to the former Farm Credit System Financial Assistance Corporation (FAC) stockholders.

We note that the two policy statements now approved largely maintain the interpretations that the Corporation adopted when it approved its prior policy statements, with changes necessary to reflect the changes in the statute. Thus, much of the discussion contained in the Federal Register publication of the predecessor policy statement

concerning adjustments in premiums, see 61 FR 16788, (April 17, 1996); 61 FR 39453 (July 29, 1996), and the Federal Register publication of the predecessor policy statement concerning AIRAs, see 65 FR 5340 (February 3, 2000); 63 FR 53423, (October 5, 1998), continues to apply.

The text of the "Policy Statement Concerning Adjustments to the Insurance Premiums" is set out below:

FARM CREDIT SYSTEM INSURANCE CORPORATION
POLICY STATEMENT CONCERNING
ADJUSTMENTS TO THE INSURANCE PREMIUMS

Background:

The Farm Credit Act of 1971, as amended (Act) established the Farm Credit System Insurance Corporation (FCSIC or Corporation) to, among other things, insure the timely payment of principal and interest on Farm Credit System obligations.² Section 5.55 of the Act mandates that the Corporation build and manage the Farm Credit Insurance Fund (Insurance Fund) to attain and maintain a secure base amount (SBA), defined as 2 percent of the aggregate outstanding insured obligations of all insured System banks

²The Agricultural Credit Act of 1987, Pub. L. 100-233 (1988), amended the Farm Credit Act of 1971 to establish the Farm Credit System Insurance Corporation. (12 U.S.C. 2277a-1 et seq.)

(excluding a percentage of State and Federally guaranteed loans and investments) or such other percentage of the aggregate amount as the Corporation in its sole discretion determines is actuarially sound. The Farm Credit System Reform Act of 1996,³ amended section 5.55 of the Act to establish in the Insurance Fund an Allocated Insurance Reserves Account (AIRA) for the benefit of each insured System bank and an AIRA for the Farm Credit System Financial Assistance Corporation (FAC) stockholders; allocate any excess balances above the SBA to these AIRAs; and make partial distributions of the excess funds in the AIRAs. Congress, by enactment of the Food, Conservation, and Energy Act of 2008 (FCE Act),⁴ amended the provisions of the Act that govern FCSIC premiums, the SBA, and AIRAs to incorporate the Corporation's recommendations concerning calculation of premiums and the SBA, and the simplification of the provisions governing AIRAs. In 2009 the Corporation adopted final regulations implementing the amended provisions of the Act governing FCSIC premiums, the SBA and AIRAs.

Applicability:

³ Pub. L. 104-105, 110 Stat. 162 (1996).

⁴ Pub. L. 110-234, Pub. L. 110-246, 122 Stat. 1651 (2008).

This policy statement will govern adjustments to premiums in response to changing conditions.

Policy Statement:

The Corporation's Board of Directors (Board) will review the premium assessment schedule at least semiannually in order to determine whether to exercise its discretion to adjust the premium assessments in response to changing conditions. The Board may reduce the premiums when the Farm Credit System demonstrates good health and sound risk management and other conditions warrant, and raise premiums to the statutory level if, for example, the amount of insured obligations increases, or the Insurance Fund suffers a significant loss or if bank capital or collateral decreases significantly before the secure base amount is achieved.

As a basis for its decision the Board will consider the following:

1. The current level of the Insurance Fund and the amount of money and time needed to reach the secure base amount in light of potential growth;
2. The likelihood and probable amount of any losses to the Insurance Fund;

3. The overall condition of the Farm Credit System, including the level and quality of capital, earnings, asset growth, asset quality, loss allowance levels, asset liability management, as well as the collateral ratios of the five banks;

4. The health and prospects for the agricultural economy, including the potential impact of governmental farm policy and the effect of the globalization of agriculture on opportunities and competition for U.S. producers; and

5. The risks in the financial environment that may cause a problem, even when there is no imminent threat, such as volatility in the level of interest rates, the use of sophisticated investment securities and derivative instruments, and increasing competition from non-System financial institutions.

In its review of the premium assessments, the Board will consider multiple scenarios that reflect the impact of potential growth in Farm Credit System debt levels on the time required to achieve the secure base amount. The secure base amount should be achieved while the Farm Credit System is in good health with very few problem institutions. Thus, the premium on adjusted average outstanding insured obligations will be set between zero

and the statutory rate of 20 basis points. The Board will not reduce the 10 basis points premium on the average principal outstanding on loans in nonaccrual status and the average amount outstanding of other than temporarily impaired investments, to continue providing an incentive for sound credit extension and administration and sound investment policy.

The text of the "Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts" is set out below:

FARM CREDIT SYSTEM INSURANCE CORPORATION
POLICY STATEMENT ON THE SECURE BASE AMOUNT AND
ALLOCATED INSURANCE RESERVES ACCOUNTS

Background:

The Farm Credit Act of 1971, as amended (Act) established the Farm Credit System Insurance Corporation (FCSIC or Corporation) to, among other things, insure the timely payment of principal and interest on Farm Credit System obligations.⁵ Section 5.55 of the Act mandates that the Corporation build and manage the Farm Credit Insurance

⁵The Agricultural Credit Act of 1987, Pub. L. 100-233 (1988), amended the Farm Credit Act of 1971 to establish the Farm Credit System Insurance Corporation. (12 U.S.C. 2277a-1 et seq.)

Fund (Insurance Fund) to attain and maintain a secure base amount (SBA), defined as 2 percent of the aggregate outstanding insured obligations of all insured System banks (excluding a percentage of State and Federally guaranteed loans and investments) or such other percentage of the aggregate amount as the Corporation in its sole discretion determines is actuarially sound. The Farm Credit System Reform Act of 1996⁶, amended section 5.55 of the Act to establish in the Insurance Fund an Allocated Insurance Reserves Account (AIRA) for the benefit of each insured System bank and an AIRA for the Farm Credit System Financial Assistance Corporation (FAC) stockholders; allocate any excess balances above the SBA to these AIRAs; and make partial distributions of the excess funds in the AIRAs. Congress, by enactment of the Food, Conservation, and Energy Act of 2008 (FCE Act)⁷, amended the provisions of the Act that govern FCSIC premiums, the SBA, and AIRAs to incorporate the Corporation's recommendations concerning calculation of premiums and the SBA, and the simplification of the provisions governing AIRAs. In 2009, the Corporation adopted final regulations implementing the

⁶ Pub. L. 104-105, 110 Stat. 162 (1996).

⁷ Pub. L. 110-234, Pub. L. 110-246, 122 Stat. 1651 (2008).

amended provisions of the Act governing FCSIC premiums, the SBA and AIRAs.

Applicability:

This policy statement will govern the calculation of the secure base amount, the determination of any excess above the SBA, the method for allocating any excess to the AIRAs, and the method for making payments from the AIRAs to accountholders.

Policy Statement:

I. SECURE BASE AMOUNT DETERMINATION

As stated in the Corporation's Policy Statement Concerning Adjustments to the Insurance Premiums, the Corporation's Board of Directors (Board) will review the premium assessments at least semiannually to determine whether to adjust premiums in response to changing conditions. The Board continues to engage in this review even after the Insurance Fund achieves the SBA because the law requires the Corporation to maintain the SBA. Thus, the Corporation must ensure that as the Farm Credit System's insured debt grows, or if the Insurance Fund suffers a significant loss, the Insurance Fund builds back to the SBA.

The Farm Credit System Reform Act of 1996 established a process for making partial distributions of the Insurance

Fund's balance above the SBA. On March 23, 2007, the Corporation's Board of Directors adopted a legislative proposal requesting that the Congress amend the Act to, inter alia, base premiums on the outstanding insured debt obligations instead of loans, permit the Corporation to collect a broader range of premiums on insured debt, and simplify the provisions concerning allocation of funds to the AIRAs and the payment of funds from the AIRAs to accountholders. Ultimately, enactment of the FCE Act in 2008 amended the provisions of the Farm Credit Act of 1971 that govern FCSIC premiums to include the Corporation's proposed changes.

As amended, the Act's provisions also reduce the total insured debt obligations on which premiums are assessed by 90 percent of Federal government-guaranteed loans and investments and 80 percent of State government-guaranteed loans and investments, and deduct similar percentages of such guaranteed loans and investments when calculating the secure base amount. The amendments also simplified the method of paying out AIRAs, prescribing that, if the aggregate of the amounts in the Farm Credit Insurance Fund exceeds the secure base amount at the end of any calendar year, the Corporation shall allocate to the AIRAs the excess amount less the amount that the Corporation, in its

sole discretion, maintains for estimated operating expenses and estimated insurance obligations of the Corporation for the following calendar year.

To begin the process, the Corporation must define the aggregate outstanding insured obligations of all the System banks. Then it must follow the steps in the statute to determine the SBA. Finally, at the end of any calendar year in which the Insurance Fund attains the secure base amount, the Corporation must determine whether any excess funds exist for allocation to the AIRAs.

The principal calculation for determining whether the Insurance Fund is at the SBA amount will be 2 percent of the aggregate adjusted insured obligations defined as follows:

(1) "Insured obligation" means any note, bond, debenture, or other obligation issued under subsection (c) or (d) of section 4.2 of the Farm Credit Act on or before January 5, 1989, on behalf of any System bank; and after such date which, when issued, is issued on behalf of any insured System bank and is outstanding at the quarter-end. The balance outstanding at the quarter-end shall include principal and accrued interest payable as reported by the banks in the call reports submitted to the Farm Credit Administration.

(2) The aggregate outstanding insured obligations of all insured System banks determined under paragraph (1) of Section I shall be adjusted downward to exclude an amount equal to the sum of (as determined by the Corporation):

(A) Ninety (90) percent of each of

(i) The guaranteed portions of principal outstanding on Federal government-guaranteed loans in accrual status made by the banks; and

(ii) The guaranteed portions of the amount of Federal government-guaranteed investments made by the banks that are not permanently impaired; and

(B) Eighty (80) percent of each of

(i) The guaranteed portions of principal outstanding on State government-guaranteed loans in accrual status made by the banks; and

(ii) The guaranteed portions of the amount of State government-guaranteed investments made by the banks that are not permanently impaired.

For the purpose of this paragraph (2), the principal outstanding on all loans made by an insured System bank, and the amount outstanding on all investments made by an insured System bank, shall be determined based on

(a) All loans or investments made by any production credit association, or any other association making direct loans under authority provided under section 7.6 of the Act, that is able to make such loans or investments because such association is receiving, or has received, funds provided through the insured System bank;

(b) All loans or investments made by any bank, company, institution, corporation, union, or association described in section 1.7(b)(1)(B) of the Act, that is able to make such loans or investments because such entity is receiving, or has received, funds provided through the insured System bank; and

(c) All loans or investments made by such insured System bank (other than loans made to any party described in paragraph (a) or (b)).

At the end of any calendar year when the Insurance Fund balance exceeds the SBA, calculated using December 31, balances, the Corporation will determine whether any excess funds exist for allocation to the AIRAs.

II. ALLOCATED INSURANCE RESERVES ACCOUNTS

Determination of Excess Insurance Fund Balances

An AIRA shall be established in the Insurance Fund for each insured System bank and for FAC stockholders. Amounts representing excess Insurance Fund balances will be

allocated to the AIRAs. The AIRAs remain a part of the Insurance Fund and are available to the Corporation.

(a) Authorized Deductions

If, at the end of any calendar year, the aggregate of the amounts in the Farm Credit Insurance Fund exceeds the secure base amount, the Corporation shall allocate to the AIRAs the excess amount less the amount that the Corporation, in its sole discretion, determines to be the sum of the estimated operating expenses and estimated insurance obligations of the Corporation for the immediately succeeding calendar year. The Corporation will budget for the next calendar year operating expenses and it will deduct the operating expenses it expects to incur. When determining estimated insurance obligations, the Corporation will include all anticipated allowances for insurance losses, claims, and other potential statutory uses of the Insurance Fund.

The excess Fund balance shall be allocated to the accounts of each insured System bank and to the FAC stockholders. The AIRA balances will be fixed at year-end until paid to account holders or used under paragraph (c). The Act provides that, not later than 60 days after receipt of a payment from the AIRAs established for the insured System banks, each insured System bank, in consultation

with affiliated associations of the insured System bank, and taking into account the direct or indirect payment of insurance premiums by the associations, shall develop and implement an equitable plan to distribute payments received among the bank and associations of the bank. The Corporation will request that each insured System bank promptly transmit to the Corporation a copy of the plan that the institution develops for the distribution of such AIRA payments.⁸

(b) Allocation Formula When Excess Funds Are Available

(1) Ten (10) percent of the excess Insurance Fund balance shall be credited to the AIRAs for all holders, in the aggregate, of FAC stock. The total amount that may be allocated to this AIRA is limited to \$35.5 million (\$56 million less the \$20.5 million that was paid out in 2010).

(2) The remaining amount of the excess Insurance Fund balance shall be credited to the AIRA for each insured System bank. There shall be credited to the AIRA of each insured system bank an amount that bears the same ratio to the total amount (less any amount credited under paragraph (b) (1) of this Section II) as--

⁸ See, Act, section 5.55(e) (6) (D), 12 U.S.C. 2277a-4(e) (6) (D) .

(i) The average principal outstanding for the calendar year on insured obligations issued by the bank (after deducting from the principal the percentages of the guaranteed portions of loans and investments described in paragraph (2) of Section I above); bears to

(ii) The average principal outstanding for the calendar year on insured obligations issued by all insured System banks (after deducting from the principal the percentages of the guaranteed portions of loans and investments described in paragraph (2) of Section I above).

(3) An example of the allocation formula is shown in the attached Exhibit 1.

(c) Use of Funds in AIRAs When Reductions Are Required

To the extent that the sum of the operating expenses of the Corporation and the insurance obligations of the Corporation for a calendar year exceeds the sum of operating expenses and insurance obligations determined under paragraph (a) of this Section II for the calendar year, the Corporation shall cover the expenses and obligations by reducing each AIRA by the same proportion, and expending the amounts so obtained before expending other amounts in the Fund.

When the Corporation's actual operating expenses and insurance obligations exceed the estimated amounts used to determine any year's AIRA balances, the Act requires AIRA balances to absorb such excess expenses before using other amounts in the Insurance Fund.⁹ To the extent reductions are made in AIRA balances to absorb Corporation expenses and actual insurance obligations, each AIRA will be reduced by its proportional amount in accordance with the statute. The same formula used to make allocations of excess Insurance Fund balances shall be used to reduce AIRA balances when necessary. Ten (10) percent of any necessary AIRA reduction will be applied to the FAC stockholder AIRA. The remaining 90 percent will be applied to the System insured banks' AIRAs on the basis of the ratio of described in paragraph (b) (2) of this Section II.

[Insert Exhibit 1 - Recent Example of Allocation and Payment]

⁹ See, Act, section 5.55(e) (5), 12 U.S.C. 2277a-4(e) (5).

Each of the revised policy statements has been approved by the Board of Directors of the Corporation. They are effective upon the date of the Board of Directors' action.

Dated: _December 15, 2011_____

Dale L. Aultman,
Secretary,
Farm Credit System Insurance
Corporation Board.

[FR Doc. 2011-32723 Filed 12/20/2011 at 8:45 am;

Publication Date: 12/21/2011]